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No. 86-781

IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

KANSAS GAS AND ELECTRIC COMPANY,
Appellant,

v.

STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS,
Appellee.

On Appeal from the Supreme Court of Kansas

APPELLANT'S REPLY TO MOTION TO DISMISS FOR LACK OF CASE OR CONTROVERSY

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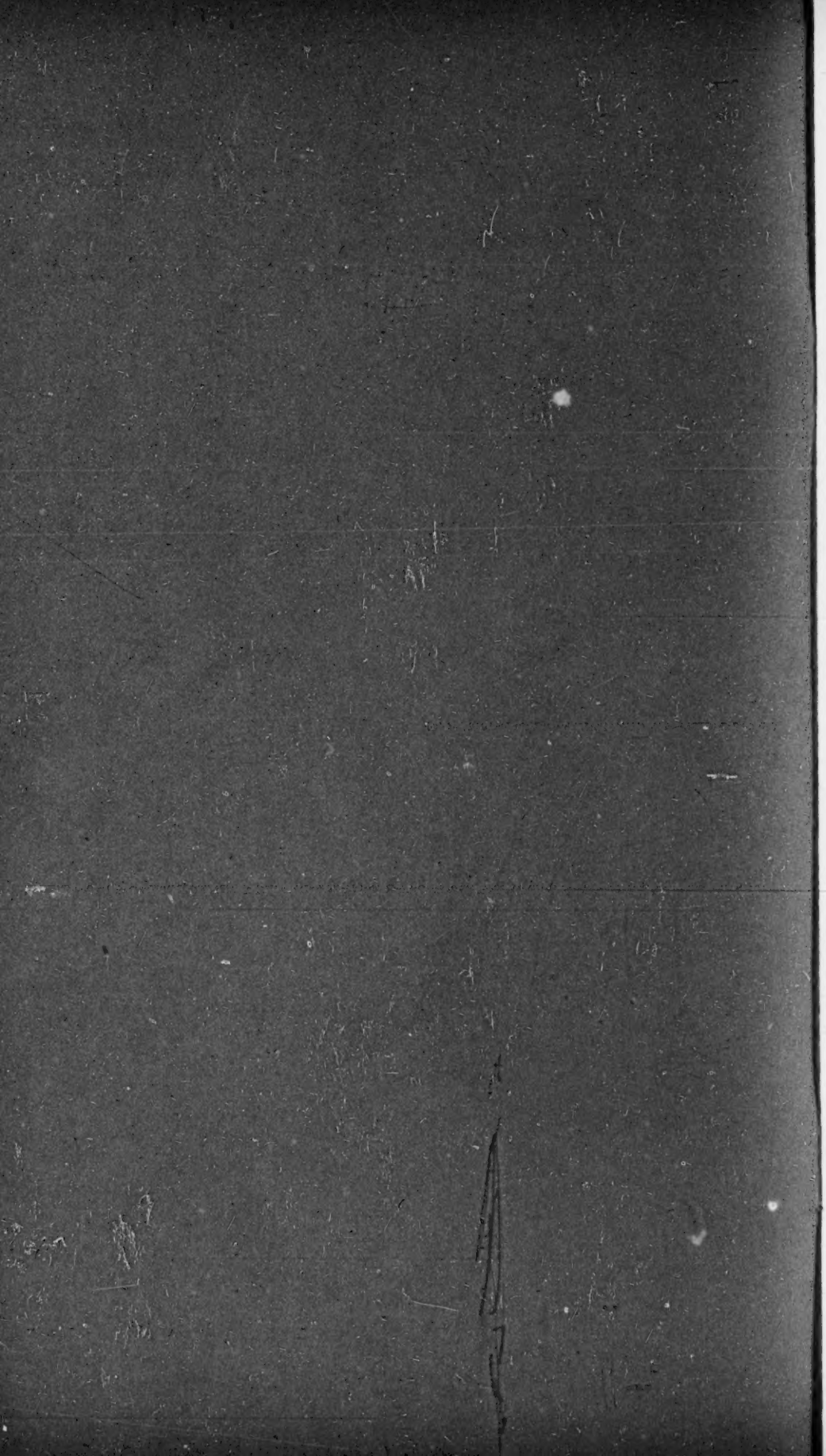

TABLE OF CONTENTS

	Page
BACKGROUND	1
ARGUMENT	3
A. KG&E Continues to Suffer Injury	3
B. Exceptions to the Mootness Doctrine	3
1. Capable of Repetition, Yet Evading Review	3
2. Voluntary Cessation	8
CONCLUSION	9

TABLE OF AUTHORITIES

Cases

Intermountain Gas Co. v. Idaho Public Utility Commission, 98 Idaho 718, 571 P.2d 1119 (Idaho 1977)	7
Michigan Bell Telephone Company v. Public Service Commission, 85 Mich. App. 163, 270 N.W.2d 546 (Mich. Ct. App. 1978)	7
National Association of Greeting Card Publishers v. United States Postal Service, 462 U.S. 810 (1983)	6
Southern Pacific Terminal Company v. Interstate Commerce Commission, 219 U.S. 498 (1911)	5, 6
State ex rel. Missouri Public Service Company v. Fraas, 627 S.W.2d 882 (Mo. Ct. App. 1981)	7
Super Tire Engineering Company v. McCorkle, 416 U.S. 115 (1974)	8
United States v. W.T. Grant Company, 345 U.S. 629 (1953)	5, 9
Weinstein v. Bradford, 423 U.S. 147 (1975)	8

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On April 13, 1987, Appellee filed a motion to dismiss this appeal for mootness or lack of a case or controversy. For the reasons set forth below, the Court should deny that motion, hear oral argument and decide this case on the merits.

BACKGROUND

On September 27, 1985, the State Corporation Commission of the State of Kansas (KCC) issued a rate order (1985 Order) setting rates for Kansas Gas and Electric Company (KG&E) to reflect the addition to rate base of KG&E's new nuclear plant, the Wolf Creek Generating

Station (Wolf Creek). The 1985 Order granted only a portion of the rate increase requested by KG&E. In setting rates, the KCC disallowed significant portions of KG&E's prudent investment in Wolf Creek because it found those amounts represented physical and economic excess capacity. The KCC's "economic excess capacity" disallowance was achieved by valuing Wolf Creek at $1290/kW, instead of its prudent net original cost of $2376/kW. As a result of the KCC's disallowances, it denied KG&E a current return on 78 percent of its prudent investment in Wolf Creek.

KG&E appealed the 1985 Order to the Kansas Supreme Court arguing that the end result of the Order was confiscatory in violation of the Fifth and Fourteenth Amendments to the United States Constitution and that the arbitrary use of an economic value for only Wolf Creek was a violation of KG&E's Fourteenth Amendment right to equal protection. The Kansas Court affirmed the 1985 Order and KG&E appealed the case to this Court.

During the pendency of the appeals, KG&E took numerous steps to mitigate the devastating effects of the 1985 Order. It reduced the dividend on common stock by 50 percent, eliminated 200 jobs, froze officers' salaries, reduced civic and charitable contributions and refinanced a large portion of its outstanding debt. As a result of these steps, KG&E was able to continue its operations with a very small profit margin.

On March 11, 1987, the KCC issued a subsequent rate order (1987 Order) dealing with KG&E's investment in Wolf Creek. This Order, which since has become final, did not set higher rates for KG&E, but instead changed the valuation of Wolf Creek for ratemaking purposes and made permanent the rates established in the 1985 Order.

In the 1987 Order, the KCC valued Wolf Creek for ratemaking purposes at its full prudent net original cost of $2376/kW instead of the $1290/kW "economic valua-

tion" used in the 1985 Order. The KCC did not find the valuation it used in the 1985 Order erroneous and has never repudiated the use of an economic valuation method. Rather, the major inducement for the KCC to revalue Wolf Creek was a plan proposed by KG&E that would avoid increasing rates to customers as a result of the revaluation. Under KG&E's plan, the KCC would revalue Wolf Creek at its prudent net original cost and, in return, KG&E agreed to combine with its utility operating revenue an $800 million stream of income from nonutility property purchased by shareholders.[1] As a result KG&E's rates will remain essentially the same.

ARGUMENT

Appellee contends that the 1987 Order renders the present appeal moot because the 1987 Order grants KG&E "virtually all" the relief requested (Motion at 3), and therefore no "issue, case, or controversy exists between KG&E and the KCC" (Motion at 8). The 1987 Order does not render this case moot. KG&E continues to suffer injury from the 1985 Order which this Court should address. Further, even if the 1987 Order provided a complete remedy, this case falls into an exception to the mootness doctrine. Given the possibility that the KCC will repeat the use of the valuation method in the future, the Court should hear this appeal.

A. KG&E Continues to Suffer Injury

As will be discussed in greater detail in KG&E's brief on the merits due to be filed with the Court on May 9, 1987, KG&E's appeal presents two major issues. These issues arise out of the valuation method used by the KCC in its 1985 Order. First, KG&E contends that as a result of the valuation of Wolf Creek at $1290/kW, KG&E received a return on its prudent investment so low that it

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[1] Normally earnings from such property would benefit only shareholders.

constitutes confiscation of KG&E's property without just compensation. Second, KG&E argues that the valuation method used by the KCC resulted in a discriminatory classification that violates KG&E's equal protection rights. Although the 1987 Order changes that method, KG&E continues to suffer injury from the 1985 Order.

The KCC correctly points out that the valuation method for Wolf Creek imposed in its 1985 Order was superceded in the 1987 Order. The valuation method adopted in 1985 is no longer in effect. Valuation of Wolf Creek at $1290/kW, however, was in effect from the issuance of the original Order on September 27, 1985, until March 11, 1987, when the new Order was issued.

KG&E suffered significant injury during that period. First, as a result of the valuation, KG&E's rates in effect from September 1985 to March 1987 were such that the return to KG&E's shareholders resulted in confiscation of KG&E's property without just compensation. The 1987 Order does not provide for collection of this past confiscation. Second, KG&E's financial health was placed in serious jeopardy. As discussed above, KG&E took drastic steps to recover its financial health. For example, immediately after the 1985 Order, KG&E reduced the dividend to common shareholders by one-half and refinanced a large portion of its debt. In doing so, KG&E has been forced to pay higher interest rates than if the KCC had valued Wolf Creek properly. These higher interest rates will continue to injure KG&E into the future.[2] Third, to persuade the KCC to revalue Wolf Creek in the 1987 Order, KG&E made several major concessions concerning

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[2] KG&E has not requested relief in the form of retroactive rates to compensate for the past confiscation or the actions taken to restore financial health. Nonetheless, those injuries have occurred and provide an example of the harm that KG&E is threatened with if the KCC returns to the valuation method used in the 1985 Order. Such an action by the KCC would require KG&E to begin this appeal process once again.

its investments. For example, to help keep rates at the current level, KG&E agreed to combine with utility operating revenue income from nonutility property purchased with shareholder funds. Fourth, because the KCC has never repudiated its "economic valuation" method, KG&E continues to be threatened by the possible future imposition of the valuation used in the 1985 Order. This threat continues to cloud KG&E's financial outlook and makes the task of obtaining financing more expensive and more difficult. These injuries were not redressed by the 1987 Order and therefore review by this Court is necessary.

B. Exceptions to the Mootness Doctrine

This Court has developed two related doctrines dealing with the possibility of future harm to a party. First, if a controversy is capable of repetition, yet evades review, this Court will decide the case instead of finding it moot. *Southern Pacific Terminal Company v. Interstate Commerce Commission*, 219 U.S. 498 (1911). Likewise, a reasonable expectation that the complaining party again will be subjected to the challenged conduct despite the defendant's voluntary cessation of the conduct pending full litigation of the issues provides a reason for this Court to decide the case. *United States v. W.T. Grant Company*, 345 U.S. 629 (1953). Both of these principles apply to the present case.

1. Capable of Repetition, Yet Evading Review

The 1985 Order challenged in this appeal is capable of repetition. The KCC has continuing jurisdiction over the rates set for KG&E and has the power under Kansas law to require KG&E to establish and maintain just and reasonable rates. K.S.A. §§ 66-101, 101b. Further, the KCC at any time may upon complaint from a customer, or on its own motion, investigate KG&E's existing rates and, if it finds them unjust or unreasonable, may order substitute rates. K.S.A. § 66-101d. Therefore, the

KCC has the opportunity at any time to repeat the ratemaking treatment imposed on KG&E in the 1985 Order. The KCC is well aware of this, and stated it repeatedly in the 1987 Order:

> . . . we have not foreclosed the possibility of further challenge to the [rates set for Wolf Creek]. . . . Nor is our action inconsistent with the possibility that at some point after the increases become effective that it would be appropriate to examine the reasonableness of KG&E's earnings. . . . any customer of KG&E, as well as the Commission staff, is always free to file a complaint alleging that KG&E's rates are unreasonable.
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> * * * *
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> Of course, the Commission also continues to have the right to reexamine all elements of KG&E's revenue requirements should it appear that its earnings or rates are unreasonably high.

Motion at A18, A33.

The continuing nature of the ratemaking process was central to the Court's decision against mootness in *Southern Pacific, supra.* In that case, the Court noted that issues decided in orders of the Interstate Commerce Commission (ICC) may influence future proceedings. Because the proceedings of the ICC are continuing, issues relevant to future cases "ought not to be, as they might be, defeated by short term orders, capable of repetition yet evading review. . . ." *Southern Pacific,* 219 U.S. at 515.

The Court recognized in *National Association of Greeting Card Publishers v. United States Postal Service,* 462 U.S. 810 (1983) that a subsequent rate order does not automatically render a case moot. That case involved a challenge to rates set for the United States Postal Service by the Postal Rate Commission. While the litigation was pending, the challenged rates were modified. The Court recognized that postal rates frequently are in effect too briefly for litigation concerning them to be completed be-

fore they are superceded and therefore held that modification of the challenged rates did not moot the controversy. *Id.* at 820, n. 14. In fact, the Court noted that in two previous cases, challenged rates had been superceded before judicial review could be concluded. *Id.* Because issues presented would be central to future proceedings and a reasonable expectation existed that the petitioner would be affected by the future proceedings, the Court refused to find the case moot.

Other courts have also recognized that a rate order issued during the pendency of an appeal of a prior rate order does not moot the controversy surrounding the first order. *See e.g., State ex rel. Missouri Public Service Company v. Fraas*, 627 S.W.2d 882 (Mo. Ct. App. 1981); *Michigan Bell Telephone Company v. Public Service Commission*, 85 Mich. App. 163, 270 N.W.2d 546 (Mich. Ct. App. 1978); *Intermountain Gas Co. v. Idaho Public Utility Commission*, 98 Idaho 718, 571 P.2d 1119 (Idaho 1977). The Missouri Court of Appeals recognized that under the general rule of mootness, when rates cannot be amended prospectively because they have been superceded by a subsequent rate order, a case is considered moot. *Fraas, supra.* The court held, however, that an exception is made when the issue presented is of a recurring nature and of general public interest and importance. The court decided to hear the case because a legal principle was involved on which a ruling was necessary for future guidance.

The rationale set forth by this Court in *National Association of Greeting Card Publishers* and in the state court decisions cited above holds true for KG&E. KG&E certainly will be affected in future proceedings by a decision in this case. This Court has recognized that in cyclically recurring actions, a particular decision "by its continuing and brooding presence, casts what may well be a substantial adverse effect on the interests of the petitioning parties." *Super Tire Engineering Company*

v. McCorkle, 416 U.S. 115, 122 (1974); *see also Weinstein v. Bradford*, 423 U.S. 147, 148 (1975) (citing *Super Tire*). The 1985 Order issued by the KCC had a devastating effect on KG&E's financial condition. The possibility that the KCC will repeat the ratemaking treatment used in the 1985 Order will have a "substantial adverse effect" on KG&E's ability to obtain future financing. Therefore, KG&E seeks assurance that the confiscatory and inherently punitive ratemaking treatment will not be imposed at some future date. Further, the issues in this case have national significance. As stated in KG&E's Jurisdictional Statement, utilities across the country have invested in nuclear generating plants awaiting final ratemaking treatment. The Brief of *Amicus Curiae* of the Edison Electric Institute In Support of Jurisdictional Statements, discusses the effect of large disallowances already imposed on utilities and stresses the importance to future ratemaking of a decision in this case.

2. Voluntary Cessation

The KCC has never repudiated the valuation method it used in the 1985 Order. In fact, the KCC stated in the 1987 Order that "there is no firm basis for reassessing the cost efficiencies of Wolf Creek." Motion at A30. The KCC revalued Wolf Creek at its prudent net original cost only because KG&E presented it with an innovative plan that satisfied the KCC's concerns. "In the application before us, KG&E has proposed a method for dealing with the issue of value in a way that deals successfully with our concerns. . . ." *Id.* The KCC, however, explicitly reserved the right to revisit the question of valuation for Wolf Creek: "Of course, if the predicates to the valuation were to change, . . . the analysis of this Commission could also change." *Id.* at A30-A31.

The KCC's actions in the 1987 Order amount to voluntary cessation of conduct with a reasonable expectation

that the conduct will be repeated. This Court recognized in *United States v. W.T. Grant Company*, 345 U.S. 629, 632 (1953), that voluntary cessation of conduct does not deprive the Court of the power to hear and determine the case. Otherwise, the "defendant is free to return to his old ways." *Id.* at 632. The Court stated that although the defendant could attempt to demonstrate that there is no reasonable expectation that the wrong will be repeated, the burden on the defendant to prove that it will not engage in the challenged practice in the future is a heavy one. *Id.* at 633.

Here, the KCC has not even attempted to meet this heavy burden. In the 1987 Order it explicitly reserved the right to examine the valuation of Wolf Creek in the future and the 1987 Order, as well as the KCC's instant motion, are glaringly silent about the valuation method the KCC would use to value Wolf Creek if KG&E's rates were challenged in a future proceeding.

CONCLUSION

KG&E suffered significant injury during the time the 1985 Order was in effect and continues to suffer injury as a result of that Order. Further, a reasonable expectation exists that the methods used in the 1985 Order will be imposed on KG&E in the future.

The fundamental issues involved in KG&E's appeal are central to utility ratemaking. A resolution of questions involving the constitutional standard for confiscation in a state ratemaking proceeding is important not only to KG&E but to utilities throughout the country. This Court has not decided a case that applies the constitutional test for confiscatory rates in a state ratemaking proceeding in a very long time. Also, the question of how the constitutional requirement of equal protection should be applied in utility ratemaking functions has never been addressed by this Court. Future ratemaking by state com-

missions and review by state courts will certainly be affected by a decision in this case. This case presents the Court with an opportunity to clarify the constitutional standards applicable to ratemaking.

For the reasons stated herein, the Court should deny the KCC's Motion to Dismiss, hear oral argument and decide the case on the merits.

Respectfully submitted,

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